

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-105533-20

Date:
October 15, 2020

Legend:

X:

Trust:

A:

State:

Date 1:

Date 2:

n:

o:

Dear :

This letter responds to a letter dated January 29, 2020, and subsequent correspondence submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted and representations made, X, a State corporation, elected to be an S corporation effective Date 1. Some spouses of X's shareholders located in community property states at the time of the election failed to properly consent to X's S corporation election. In addition, Trust, an ineligible S corporation shareholder, owned shares of X stock on Date 1. Consequently, X's S corporation election was ineffective.

Beginning on Date 2 and over the next n years, X inadvertently issued shares of stock to A's individual retirement account (A's IRA), an ineligible S corporation shareholder. Had X's S corporation election been effective, it would have terminated on Date 2 when shares of X stock were issued to A's IRA. Once X realized that A's IRA, and not A, held shares of its stock, X repurchased the shares from A's IRA and reissued them to A.

X represents that X and its shareholders treated X as an S corporation. X filed its income tax returns consistent with having a valid S corporation election effective Date 1. Moreover, during the time that A's IRA held shares of X stock, A, and not A's IRA reported X's S corporation items on A's individual tax returns as though A owned the stock directly. X further represents that the ineffectiveness of its S corporation election, and any subsequent termination had its S corporation election been valid, were inadvertent and not motivated by tax avoidance or retroactive tax planning. X represents that X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) that may be required by the Secretary.

LAW

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(a)(2) provides that an election to be an S corporation shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(a)(2)(i) of the Income Tax Regulations provides that the election to be an S corporation is not valid unless all shareholders of the corporation at the time of the election consent to the election in the manner provided in § 1.1362-6(b).

Section 1.1362-6(b)(2)(i) provides that when stock of the corporation is owned by husband and wife as community property (or the income from the stock is community property), each person having a community interest in the stock or income therefrom must consent to the election.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or was terminated under § 1362(d)(2), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation or to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's S corporation election was ineffective on Date 1 because some persons having a community interest in X's stock failed to consent to X's S corporation election and Trust, an ineligible S corporation shareholder, owned shares of X stock on Date 1. In addition, we conclude that had X's S corporation election been effective, it would have terminated on Date 2 when shares of X's stock were transferred to A's IRA, an ineligible S corporation shareholder. We conclude, however, that the ineffectiveness and termination described in this paragraph were inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation effective Date 1 and thereafter, provided that its S corporation election was otherwise valid and has not terminated under § 1362(d) other than as discussed in this letter.

As a condition to this ruling, any spouse of a shareholder located in a community property state that did not sign X's Form 2553, Election by a Small Business Corporation, must sign a written statement as described in § 1.1362-6(b)(1) consenting to X's S corporation election effective Date 1. The written statement(s) must be filed with the appropriate service center within 120 days from the date of this letter, indicating that the statement(s) are to be associated with X's originally filed Form 2553.

Furthermore, as an adjustment under § 1362(f)(4), a payment of \$0 and a copy of this letter must be sent to the following address within 45 days from the date of this letter: Internal Revenue Service, Kansas City Submission Processing Campus, Attn: Manual Deposit, 333 W. Pershing Road, Stop 7777, Kansas City, MO 64108.

If the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the service center with which it filed its S corporation election that its election terminated on Date 1.

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. In particular, we express or imply no opinion regarding X's eligibility to be an S corporation.

The ruling contained in this letter is based on information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter ruling to your authorized representatives.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6011 purposes

cc: